Testimony of

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On behalf of the

INDEPENDENT COMMUNITY BANKERS OF AMERICA

Before the

FINANCIAL INSTITUTIONS AND CONSUMER CREDIT SUBCOMMITTEE

HOUSE FINANCIAL SERVICES COMMITTEE

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Good morning Chairman Bachus, Ranking Member Waters, and members of the Committee. My name is Robert I. Gulledge, and I am chairman, president and CEO of Citizens Bank, a community bank with $75 million in assets, located in Robertsdale, Alabama. I also serve as Chairman of the Independent Community Bankers of America (ICBA)[1] on whose behalf I appear before you today. I want to thank you for giving me the opportunity to testify today on the very important issue of deposit insurance reform.

I want to commend you, Chairman Bachus, and full committee Chairman Oxley, for scheduling this hearing and giving this matter priority attention. Deposit insurance is of enormous importance to community banks and their customers—and to the safety and soundness of our financial system.

Few would dispute that federal deposit insurance has been an enormously successful program, enhancing financial and macro-economic stability by providing the foundation for public confidence in our banking and financial system. It has done what it was established to do—it has prevented bank runs and panics, and reduced the number of bank failures. Even at the height of the S&L crisis, there was no panic or loss of confidence in our financial system. The financial system and our economy are stronger and less volatile because of Federal deposit insurance.

But it has now been more than 10 years since the last systematic congressional review of our deposit insurance system, and it must be modernized and strengthened. In the past two decades since deposit insurance levels were last increased, inflation has ravaged the value of deposit insurance coverage. The less deposit insurance is really worth due to inflation erosion, the less confidence Americans will have in the protection of their money, and the soundness of the financial system will be diminished.

The system currently remains strong, the industry is strong and the overwhelming majority of institutions are healthy, but as the FDIC states in its report *"Keeping the Promise: Recommendations for Deposit Insurance Reform"* (FDIC Report), there are emerging problems and room for improvement.

The financial services trade associations have been discussing deposit insurance reform issues. And we share a common goal to work together, and to work with this committee, on areas of mutual concern, to craft a bill and pass legislation.

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[1] ICBA is the primary voice for the nation's community banks, representing 5,500 institutions at nearly 16,700 locations nationwide. Community banks are independently owned and operated and are characterized by attention to customer service, lower fees and small business, agricultural and consumer lending. ICBA's members hold more than $491 billion in insured deposits, $589 billion in assets and more than $344 billion in loans for consumers, small businesses and farms. They employ nearly 232,000 citizens in the communities they serve. For more information, visit www.icba.org.

Now, while we can do it in a non-crisis atmosphere, is the time to consider improvements to enhance the safety and soundness of our federal deposit insurance system and ensure that the effectiveness of this key element of the safety net is not undermined.

Emerging Issues
The major deposit insurance reform issues that have emerged and should be addressed by legislation include:

- preserving the value of FDIC protection and coverage for the future by substantially increasing coverage levels and indexing these new base levels for inflation;
- establishing a pricing structure so that rapidly growing "free-riders" pay their fair share into the deposit insurance funds (these free riders like Merrill Lynch and Salomon Smith Barney also offer coverage levels well beyond the reach of community banks);
- smoothing out premiums to avoid wild swings caused by the hard target reserve ratio (so banks do not pay unreasonably high premiums when they and the economy can least afford it); and
- providing appropriate rebates of excess fund reserves.

FDIC RECOMMENDATIONS

The recommendations contained in the FDIC report address each of the foregoing issues. Mr. Chairman, I will structure my testimony today around the recommendations and key issues outlined in the FDIC report.

1. Deposit Insurance Coverage Levels Have Been Badly Eroded By Inflation And Should Be Increased And Indexed For Inflation

For community bankers, the issue of increased deposit insurance coverage has been front and center in the deposit insurance debate. More coverage would benefit their communities, and their consumer and small business customers. It would help address the funding challenges and competitive inequities faced by community banks and ensure that they have lendable funds to support credit needs and economic development in their communities. For community bankers, any reform package will fall far short if it does not include a substantial increase in coverage levels and indexation.

FDIC Recommendation: ***"The deposit insurance coverage level should be indexed to maintain its real value."***
The FDIC proposes to increase coverage levels to make up for inflation's devaluing effects. The agency suggests making coverage levels more predictable by automatically adjusting the levels every five years based on the Consumer Price Index. But it did not make a recommendation on what to use as the "base year," saying this decision should be left to the Congress. Using 1980 as the base year would raise coverage levels to nearly $200,000 (see **Chart 1** attached); using 1974 as the base year—the year coverage levels were raised to $40,000—would boost coverage to around $137,000 today.

ICBA Position

The ICBA strongly supports legislation introduced by Rep. Joel Hefley (R-CO) and Sens. Tim Johnson (D-SD) and Chuck Hagel (R-NE) to raise federal deposit insurance coverage levels. Both bills (H.R. 746 and S. 128) would increase FDIC coverage levels to around $200,000 and provide for automatic inflation adjustments (based on an IRS index) every three years rounded up to the nearest thousand dollars. Both bills have garnered substantial bi-partisan support. Fifty-one Representatives have signed onto the Hefley bill, consisting of 30 Republicans and 21 Democrats. Thirteen Senators are on the Johnson bill, five Republicans and eight Democrats.

Coverage Levels Ravaged by Inflation

The general level of income, prices and wealth in our Nation has been steadily increasing for decades. As a consequence, inflation is severely eroding the value of FDIC protection. The current deposit insurance limit is economically inadequate and unacceptable for today's savings needs, particularly growing retirement savings needs as the boomer generation reaches retirement age.

The real value of $100,000 coverage is only about half what it was in 1980 when it was last increased. **Chart 2**, which is attached, shows that simply adjusting for inflation, the $100,000 limit set in 1980 represents only $46,564 in coverage today. Worse yet, as **Table 1** shows, in real terms, today's deposit insurance limit is worth $20,000 **less** than it was in 1974 when the deposit insurance limit was doubled to $40,000.

Looked at another way, in 1934, when federal deposit insurance was established, the coverage level was 10 times per capita annual income. Today, it is only four times per capita income. During the last two decades, while deposit insurance levels remained unchanged, financial asset holdings of American households have quadrupled, from $6.6 trillion in 1980 to $30 trillion in 1999.

Deposit insurance coverage levels have been increased six times since the program was created in 1934. But the increases have been done on an ad hoc basis with no predictability either on timing or the size of the increase. We need to move away from ad hoc increases, and move to a system that is predictable and grows with inflation.

Gallup Poll Shows Consumers Want Increase

A recent survey conducted by The Gallup Organization [2], on behalf of the FDIC, revealed that Federal deposit insurance coverage is a "significant factor" in investment decisions, especially to more risk-averse consumers and those making decisions in older and less affluent households.

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[2] The Gallup Organization conducted telephone interviews with a randomly selected, representative sample of 1,658 adults who identified themselves as the people most knowledgeable about household finances age 18 or older, living in households with telephone service in the continental United States. The interview period ran from November 20 to December 23, 2000. The margin of error is plus or minus 3 percent.

Fifty-seven percent of respondents said deposit insurance is "very important" in determining where to invest.

Six in ten respondents said they would be likely to put more of their household's money into insured bank deposits if the coverage level of deposit insurance were raised. And six in ten said they would move their money into insured accounts as they neared retirement age or during a recession. The survey also showed that one in eight households keep more than $100,000 in the bank, and about one-third of all households reported having more than $100,000 in the bank at one time or another.

And importantly, the Gallup survey indicated that nearly 4 out of 5 (77%) respondents thought deposit insurance coverage should keep pace with inflation.

Small Business Customers Support Increase
Small businesses are key customers of community banks, which in turn are premier providers of credit to these businesses. A recent [3]study commissioned by the American Bankers Association (ABA) found that half of small business owners think the current level of deposit insurance coverage is too low. When asked what actions they would take if coverage were doubled, 42 percent said they would consolidate accounts now held in more than one bank; 25 percent would move money to smaller banks; and 27 percent would move money from other investments into banks.

Consumers and small businesses shouldn't have to spread their money around to many banks to get the coverage they deserve. They should be able to support their local banks, and local economies, with their deposits.

Deposit Insurance a Critical Tool to Support Local Lending
An adequate level of deposit insurance coverage is vital to community banks' ability to attract core deposits, the funding source for their community lending activities. Many community banks are facing funding pressures and are finding it difficult to keep up with loan demand as they lose deposits to mutual funds, brokerage accounts, the equities markets and "too-big-to-fail" banks.

The growth in bank loans is outpacing the growth in deposits by about 2 to 1. Average loan-to-deposit ratios are at historical highs. In turn, community bankers are encountering growing liquidity problems. According to Grant Thornton's "Eighth Annual Survey of Community Bank Executives,"[4] 77 percent of community bankers favor raising the insurance coverage from its current level of $100,000 in order to make it easier to attract and retain core deposits.

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[3] "Increasing Deposit Insurance Coverage: Implications for the Federal Insurance Funds and for Bank Deposit Balances," Mark J. Flannery, December 2000 (study commissioned by the ABA).

[4] "The Changing Community of Banking," 2000 Seventh Annual Survey of Community Bank Executives, published by Grant Thornton LLP, March, 2001.

Some banks have seen a surge in deposit activity during the last quarter. The instability of the stock market has caused some weary investors to pull out of the equities market and return to the safety and stability of banks. But most observers believe this is an aberration that may not continue when the market turns back up. Moreover, this phenomenon provides deposits to banks in a down economy when loan demand is weakened; it does not help address the need for funding when loan demand is strong.

Large complex banking organizations (LCBOs) have an inherent funding and deposit gathering advantage over community banks because they have the ultimate subsidy—the systemic risk their failure poses to the financial system makes them "too-big-to-fail." Depositors in too-big-to-fail banks, where uninsured depositors are made whole, may not have to worry about the safety of their deposits, regardless of how much they exceed \$100,000.[5] The Gramm-Leach-Bliley Act of 1999, permitting the common ownership of banks, insurance companies and securities firms, is fostering the creation of even more LCBOs of nationwide scope.[6]

Community banks will never achieve true competitive equity with too-big-to-fail banks because their depositors will never be afforded the same protection that depositors at too-big-to-fail megabanks enjoy. But increased deposit insurance coverage levels will help community banks compete for deposits with large banks.

Alternative funding sources for community banks are scarce. Because of our small size, we have limited access to the capital markets for alternative sources of funding. Liberalized access to the Federal Home Loan Bank System advance window under the Gramm-Leach-Bliley Act of 1999 will help. But Federal Home Loan Bank advances are not a substitute for deposits. Bankers must pay higher rates for advances and other non-traditional funding than they do for deposits, putting pressure on net interest margins. Examiners are warning community banks against over-reliance on FHLB advances.

Full Coverage For Public Deposits

The ICBA also supports full deposit insurance coverage for public deposits.

States require banks to collateralize public deposits by pledging low-risk securities to protect the portion of public deposits not insured by the FDIC. This makes it harder for community banks to compete for these deposits with larger banks. Many community banks are so loaned-up that they do not have the available securities to use as collateral.

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[5] Thomas M. Hoenig, president of the Federal Reserve Bank of Kansas City, noted in a speech on March 25, 1999, *"To the extent that very large banks are perceived to receive governmental protection not available to other banks, they will have an advantage in attracting depositors, other customers and investors. This advantage could threaten the viability of smaller banks and distort the allocation of credit."*

[6] In a speech before the National Bureau of Economic Research Conference on January 14, 2000, Federal Reserve Board Governor Laurence H. Meyer said, *". . . the growing scale and complexity of our largest banking organizations. . . raises as never before the potential for systemic risk from a significant disruption in, let alone failure of, one of these institutions."*

And those that do have to tie up assets in lower yielding securities which could affect their profitability and ability to compete. In addition, collateralizing public deposits takes valuable resources away from other community development and lending activities.

FDIC Recommendation. The FDIC did not make a recommendation on insurance coverage for public deposits. Rather, it said it should be explored further. FDIC did state, however, that "Raising the coverage level on public deposits could provide banks with more latitude to invest in other assets, including loans. Higher coverage levels might also help community banks compete for public deposits and reduce administrative costs associated with securing these deposits."

Providing 100 percent coverage for public deposits would free up the investment securities used as collateral, enable community banks to offer a more competitive rate of interest in order to attract public deposits, and enable local governmental units to keep deposits in their local banks as a valuable source of funding that can be used for community lending purposes.

Full Coverage For IRAs And Retirement Accounts

Retirement savings require a deposit insurance limit higher than $100,000. Today, accumulating $100,000 in savings for education, retirement, or long-term care needs, is not a benchmark of the wealthy. With the graying of the population, safe savings opportunities are needed more than ever. An insured savings option is becoming even more crucial now that budget surpluses are reducing the supply of Treasury securities.

FDIC Recommendation. The FDIC did not take a position on this topic. However, the report stated: "Because retirement accounts tend to be long-term investments, over time they can reach relatively large balances that exceed the coverage provided by FDIC insurance. Thus, raising the coverage level on IRAs could encourage depositors to invest more of their retirement savings in insured bank deposits."

FDICIA Reforms Minimize Taxpayer Exposure

Critics of proposals to substantially increase and index coverage levels contend that the 1980 increase to $100,000 was unjustified and increased the resolution costs of the savings and loan crisis. Overlooked, perhaps, is the fact that the Federal Reserve Board advocated this increase at the very time its monetary policies were driving the prime rate over 20 percent to wring inflation out of the economy. Also overlooked is the fact that the new $100,000 coverage limit helped stem depositor panic as thousands of thrifts holding long-term, fixed-rate loans failed from the resulting severe asset-liability mismatch.

Higher limits will not necessarily increase exposure to the FDIC or the taxpayer. There are a variety of factors that serve to minimize any increase in exposure to the FDIC or the taxpayer from bank failure losses due to an increase in deposit insurance coverage levels.

The reforms in bank failure resolutions instituted by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) -- including prompt corrective action, least cost resolution, depositor preference, and a special assessment when a systemic risk determination is made -- are designed to reduce losses to the FDIC.

Prompt corrective action helps ensure swift regulatory action when a bank becomes critically undercapitalized so that losses do not increase while the bank's condition further deteriorates. Least cost resolution requires that—except in the case where the systemic risk exception is invoked—the FDIC uses the least costly method when a bank fails to meet its obligations to pay insured depositors only. And depositor preference minimizes the FDIC's losses by requiring that assets of the failed institution are first used to pay depositors, including the FDIC standing in the shoes of insured depositors, before other unsecured creditors are paid. And when a systemic risk determination is made, the FDIC must charge all banks an emergency special assessment to repay the FDIC's costs for the rescue.

Perhaps most importantly, the coverage issue must be considered in conjunction with the pricing and hard reserve ratio issues. As the FDIC seeks to ensure that deposit insurance premiums adequately reflect the risk profiles of individual banks, whether there is a higher or lower coverage limit becomes less relevant. Former Federal Reserve Vice Chairman Alan S. Blinder, in a recently released study of FDIC reforms[7], said : "In a world of properly-priced deposit insurance, it seems more appropriate to ask. . . :Why have *any* coverage limits at all?" Mr. Blinder added that it is "axiomatic" that the new coverage limit, "wherever it is set initially, should be indexed."

2. "Free Riders" Must Pay Their Fair Share

FDIC Recommendation: *"The FDIC should charge regular premiums for risk regardless of the level of the fund."*

The FDIC recommends that the current statutory restriction on the agency's ability to charge risk-based premiums to all institutions should be eliminated, and the FDIC should be allowed to charge premiums, even when the fund is above the 1.25 percent designated reserve ratio (DRR).

Currently, the FDIC is restricted from charging premiums to well-capitalized, highly rated banks so long as the reserve level remains above the target. As a result, 92 percent of the industry does not pay any premiums, and the more than 900 banks that were chartered within the last five years have never paid any premiums. According to the FDIC, this system underprices risk and does not adequately differentiate among banks according to risk.

Remedy to Free Rider Problem Needed

Because of the current premium restrictions, rapidly growing institutions do not pay their fair share for deposit insurance coverage. By the end of the first quarter of 2001, Merrill Lynch and Salomon Smith Barney had moved a total of $83 billion in deposits under the

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[7] "Reform of Deposit Insurance – A Report to the FDIC," by Alan S. Blinder and Robert F. Wescott, March 20, 2001.

FDIC-BIF umbrella through two banks that Merrill owns and six banks affiliated with Salomon Smith Barney, without paying a penny in deposit insurance premiums. This dilutes the FDIC-BIF's reserve ratio, which is already lagging behind the FDIC-SAIF's which doesn't face a similar inflow problem. Every $100 billion of insured deposit inflows drops the reserve ratio of the FDIC-BIF—which stood at 1.35 percent on December 31, 2000—about six basis points.

Once the 1.25 percent reserve ratio is breached, FDIC is required by law to assess banks a minimum average of 23 cents in premiums unless a lower premium can recapitalize the fund within one year. How long it will be before the 1.25 percent designated reserve ratio is breached and premiums are triggered for all banks is not known. Today, past assessments on banks are subsidizing the insurance coverage for Merrill Lynch and Salomon Smith Barney! This inequitable situation must be remedied.

Because Merrill Lynch and Salomon Smith Barney own multiple banks, they can offer their customers more than $100,000 in insurance coverage. Merrill with two banks can offer $200,000 in FDIC coverage, and Salomon Smith Barney is offering each of its customers $600,000 in FDIC protection. This could have a significant negative impact on the funding base of community banks. Most community banks cannot offer their customers more than $100,000 in deposit insurance coverage in this manner. Additionally, these huge institutions are too-big-to-fail, which gives them another advantage over community banks in gathering deposits.

If the FDIC were able to charge premiums to all banks, even when the reserve level is above 1.25 percent, it could collect premiums from Merrill Lynch and Salomon Smith Barney as they move deposits under the insurance umbrella. As it now stands, the FDIC is prohibited from charging them anything. Furthermore, if their banks grew at a particularly fast rate, posing a greater risk, they could be charged premiums at a higher rate.

Ney Bill

Legislation introduced by Rep. Bob Ney (R-OH) would address the free rider problem by giving the FDIC the authority to impose a special assessment on the free riders—indeed, any depository institution whose deposits grow at a rate faster than a rate determined by the FDIC—to pay for the insurance coverage.

ICBA Position on Regular Premiums

The recommendation to charge premiums to all banks, even when the fund is fully capitalized, faces controversy. However, we believe that in a carefully constructed, integrated reform package which includes substantial increases in deposit insurance coverage levels, bankers would be willing to pay a small, steady premium in exchange for increased coverage levels and less volatility in premiums. With a small, steady premium, bankers will be better able to budget for insurance premiums and avoid being hit with an unexpected high premium assessment during a downturn in the business cycle. Also, the premium swings will be less volatile and more predictable. It is also one way to extract some level of premiums from the free riders and reduce the dilution of the reserve ratio.

3. Risk Based Premium System Should Set Pricing Fairly

FDIC Recommendation: ***"The current statutory restriction on the FDIC's ability to charge risk-based premiums to all institutions should be eliminated"***
The current method of determining a bank's risk category for premiums looks at two criteria—capital levels and supervisory ratings. The FDIC argues that this risk weighting system is inadequate since it allows 92 percent of all banks to escape paying any premiums when the fund is fully capitalized. The FDIC says that it cannot price risk appropriately under this method.

The FDIC has proposed a sample "scorecard" to charge premiums based on a bank's risk profile. The FDIC is quick to point out that this example is not etched in stone, and the factors to be used to stratify banks by risk deserves more analysis and discussion. But the FDIC model can be used as a starting point.

The FDIC proposes to disaggregate the highest-rated category of banks that currently do not pay any insurance premiums (92%) into three separate risk categories based on a scorecard using examination ratings, financial ratios and, for large banks, possibly certain market signals as inputs to assess riskiness.

Under this system, three premium subgroups would be created--42.7 percent of the currently highest-rated institutions would pay a 1 cent premium, 26.5 percent would pay 3 cents, while another 23 percent would pay a 6 cent premium.

The eight percent of institutions that are currently charged premiums under the current system would fall into higher-risk categories and pay premiums ranging from 12 to 40 cents, as contrasted to the 3 to 27 cents they pay under the current system.

Under this example, the FDIC would collect $1.4 billion in annual premiums for an industry average of 3.5 cents.

ICBA Position
The ICBA and community bankers generally support a risk-based premium system. However, we believe more study is needed to determine the appropriate risk factors and risk weighting to be used in the matrix. Reaching consensus on the factors to be used to stratify banks into risk categories and the premiums to be charged in the various categories will take more thought and discussion.

We are concerned that under the FDIC proposal, nearly 50 percent of banks that do not pay any insurance premiums now would be paying either a 3 or 6 cent premium (before rebates) during good times. We are also concerned that this system could create a reverse-moral hazard by encouraging banks to squeeze risk out of their operations and in the process reduce the amount of lending they do in their communities. Banking is not a risk-free enterprise. Appropriate stratification of banks by risk and appropriate premium levels are issues that our policy bodies will continue to study over the next several months.

We do recommend, however, that while it would be appropriate for Congress to establish parameters or guidelines for a risk based premium structure, the details of the structure should be set by the FDIC through the rule-making process with notice and comment from the public. The FDIC is in a better position to judge the relative health of the insurance funds and the industry and can react more quickly to make changes in the premium structure as necessary.

4. Premiums Should Be Smoothed Out And Volatility Reduced

FDIC Recommendation: ***"Sharp premium swings triggered by deviations from the DRR should be eliminated. If the fund falls below a target level, premiums should increase gradually. If it grows above a target level, funds should be rebated gradually. Rebates should be based on past contributions to the fund, not on the current assessment base."***

The current statutory requirement of managing the fund to the hard 1.25 percent DRR can lead to volatile premiums with wide swings in assessments. As already noted above, under the current system, well-capitalized and well run banks cannot be charged premiums so long as the reserve ratio is above the DRR of 1.25 percent. However, when the reserve level falls below 1.25 percent, the law requires the FDIC to charge an average of 23 cents in premiums unless the fund can be recapitalized at a lower premium in one year.

This means there could be wild fluctuations in premium assessments, depending on the extent of bank failure losses. The current system is dangerously pro-cyclical with premiums the highest when banks and the economy can least afford it. Premiums could rise rapidly to 23 cents when economic conditions deteriorate, potentially exacerbating the economic downturn, precipitating additional bank failures and reducing credit availability by removing lendable funds from banks.

The FDIC recommends that the 1.25 percent hard target be eliminated, and the reserve ratio be allowed to fluctuate within a given range. The FDIC argues that the deposit insurance system should work to smooth economic cycles, not exacerbate them.
For example, maintaining the current DRR of 1.25 percent as a target, the reserve ratio could be allowed to fluctuate between 1.15 percent and 1.35 percent. Regular risk-based premiums would be charged so long as the ratio is within that range.

However, in years when the ratio is below 1.15 percent, the FDIC suggests a "surcharge," for example, equal to 30 percent of the difference between the reserve ratio and 1.15 percent. Alternatively, in years when the ratio is above 1.35 percent, there would be a rebate equal to 30 percent of the difference between the reserve level and 1.35 percent. This would ensure that premiums rise and fall more gradually than under the current system.

ICBA Position

The ICBA supports eliminating the hard 1.25 percent DRR and instituting a range within which the funds can fluctuate without penalty or reward as part of a comprehensive reform package. Under the current system, banks could be faced with steep deposit insurance payments when earnings are already depressed. Such premiums would divert billions of dollars out of the banking system and raise the cost of gathering deposits at a time when credit is already tight. This in turn could cause a further cutback in credit, resulting in a further slowdown of economic activity at precisely the wrong time in the business cycle. The agency says it would be preferable for the fund to absorb some losses and for premiums to adjust gradually, both up and down, around a target.

The FDIC also makes a strong case for maintaining 1.25 percent as the mid-point of such a range. The FDIC report showed that under various loss scenarios (no loss, moderate loss and heavy loss), the fund never drops below .80 percent and it never goes above 1.5 percent. Gradual surcharges and gradual rebates help to keep the fund within this range.

Rebates. Pricing and rebates go hand-in-hand. If premiums are charged to all institutions regardless of the fund's size after deposit insurance levels are substantially increased, rebates represent a critical safety valve to prevent the fund from growing too large. FDIC notes that in the best years, the rebate could result in a bank receiving a net payment from the FDIC. In an economy as relatively strong as we have today, more than 40 percent of banks would receive a net rebate.

Importantly, under the FDIC proposal, the rebates would be based on past contributions to the insurance fund, and not on the current assessment base. This would have two advantages. It would not create a moral hazard which would encourage banks to grow just to get a higher rebate. And it would not unjustly enrich companies like Merrill Lynch and Salomon Smith Barney, which have transferred large deposits under the insurance umbrella without paying any premiums.

We strongly support this recommendation on rebates. It is only fair to those institutions who have paid into the insurance fund for years. And it would prevent free riders like Merrill Lynch and Salomon Smith Barney from earning rebates on premiums they never paid.

5. Merge the BIF and SAIF As Part of Comprehensive Reform Plan

Historically, banks and thrifts have had their own insurance funds. The FDIC-BIF and the FDIC-SAIF offer identical products, but premiums are set separately. Since the S&L crisis, when many banks acquired thrift deposits, many institutions now hold both BIF- and SAIF- insured deposits. More than 40 percent of SAIF-insured deposits are now held by banks.

FDIC Recommendation: ***"The Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) should be merged now."***

The FDIC proposes to merge the BIF and the SAIF as part of an overall reform package. The agency argues that the lines between savings and loans and banks have blurred to the point where it is difficult to tell them apart.

They argue that merging the two funds would make the combined fund stronger, more diversified and better able to withstand industry downturns than two separate reserve pools. FDIC says costs also would go down since the FDIC would not need to track separate funds.

ICBA Position

The ICBA supports a merger of the BIF and SAIF so long as it is part of a comprehensive and integrated deposit insurance reform package that includes an increase in coverage levels.

Conclusion

In summary, Mr. Chairman, the ICBA believes it is critical to review the federal deposit insurance system now in a non-crisis atmosphere. An ongoing strong deposit insurance system is essential for future public confidence in the banking system and to protect the safety and soundness of our financial system. The effectiveness of this key government agency should not be permitted to be undermined or eroded away by a failure to preserve the value of its protection.

Deposit insurance is critical to the thousands of communities across America that depend on their local community bank for their economic vitality. Without substantially increased deposit insurance coverage levels indexed for inflation, community banks will find it increasingly difficult to meet the credit needs of their communities and compete fairly for funding against too big to fail institutions and non-bank providers.

We support the overall thrust of the FDIC's recommendations and agree that deposit insurance reform should be comprehensive. Coverage levels should be raised and indexed for inflation. The 1.25 percent designated reserve ratio should be scrapped in favor of a flexible range. The statutory requirement that banks pay a 23 cent premium when the fund drops below the DRR should be repealed. A pricing structure that fairly evaluates the relative risks of individual banks should be instituted. Full deposit insurance coverage should be accorded to public deposits. And IRAs, savings and retirement accounts should be accorded higher coverage levels. We urge Congress to adopt such an integrated reform package.

We commend you, Mr. Chairman, and Chairman Tanoue for moving the debate forward. The ICBA pledges to work with you, the entire committee, and our industry partners, to craft a comprehensive and integrated deposit insurance reform bill that can work and can pass.

Thank you, Mr. Chairman, for the opportunity to express the views of our nation's community bankers.

TABLE 1

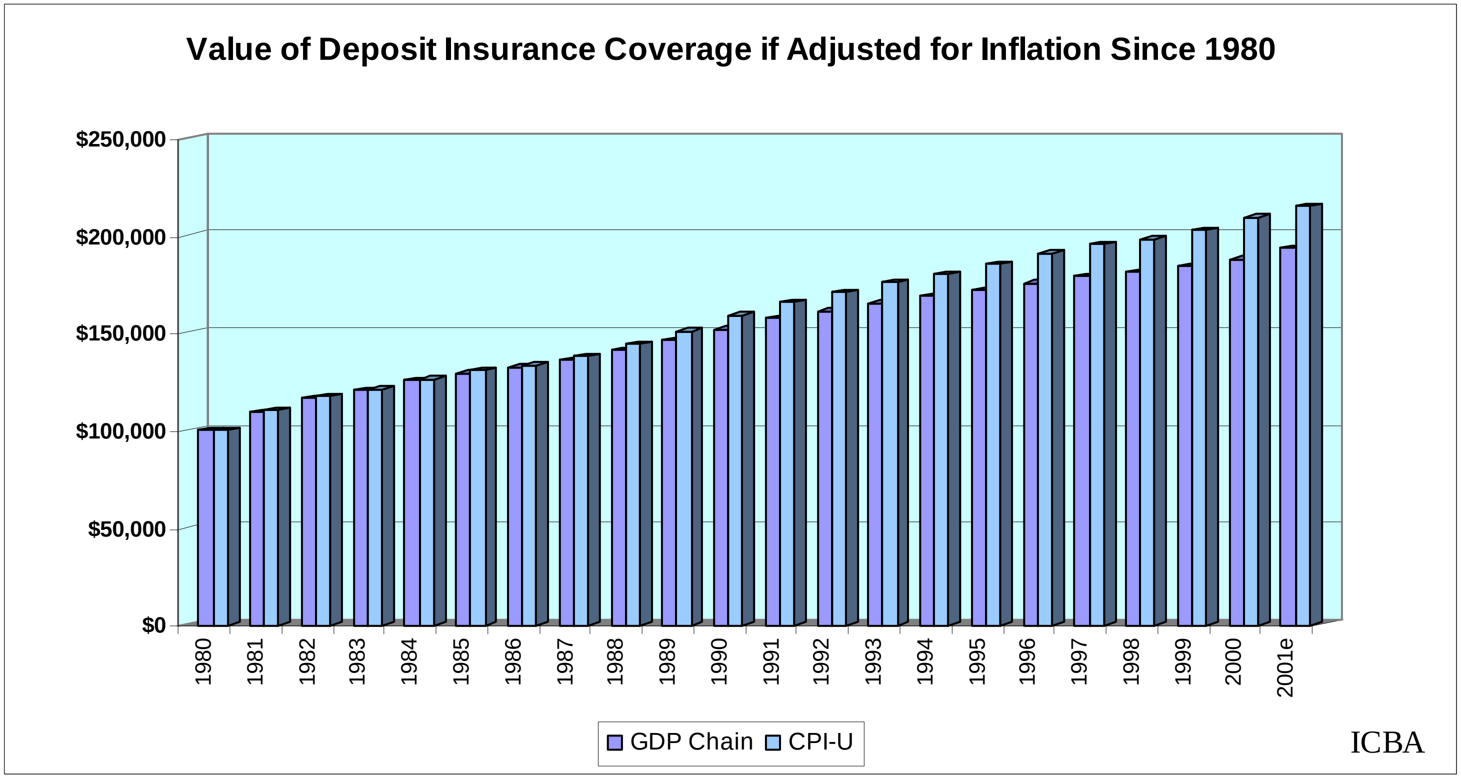
Federal Deposit Insurance Limit
Adjusted for Inflation
$1980 Dollars

Year	GDP Chain Price Index 1996=100	Adjusted GDP Chain Price Index 1980=100	CPI-U 82-84=100	Adjusted CPI-U 1980=100	Nominal Dollar Deposit Insurance Limit 1974 - Present	Real Dollar Deposit Insurance Limit (GDP Chain) 1974 - Present	Real Dollar Deposit Insurance Limit (CPI-U) 1974 - Present
1974	36.61	64.2	49.3	59.9	**$40,000**	**$62,344**	**$66,820**
1975	40.03	70.2	53.8	65.3	$40,000	$57,013	$61,223
1976	42.30	74.1	56.9	69.1	$40,000	$53,957	$57,881
1977	45.02	78.9	60.6	73.6	$40,000	$50,696	$54,363
1978	48.23	84.5	65.2	79.2	$40,000	$47,319	$50,510
1979	52.24	91.6	72.6	88.1	$40,000	$43,685	$45,401
1980	57.05	100.0	82.4	100.0	**$100,000**	**$100,000**	**$100,000**
1981	62.37	109.3	90.9	110.4	$100,000	$91,478	$90,598
1982	66.26	116.1	96.5	117.2	$100,000	$86,107	$85,342
1983	68.87	120.7	99.6	120.9	$100,000	$82,838	$82,728
1984	71.44	125.2	103.9	126.2	$100,000	$79,864	$79,266
1985	73.70	129.2	107.6	130.6	$100,000	$77,417	$76,564
1986	75.32	132.0	109.7	133.1	$100,000	$75,744	$75,104
1987	77.57	136.0	113.7	138.0	$100,000	$73,547	$72,446
1988	80.22	140.6	118.4	143.7	$100,000	$71,122	$69,610
1989	83.27	146.0	124.0	150.5	$100,000	$68,515	$66,425
1990	86.53	151.7	130.8	158.7	$100,000	$65,934	$63,008
1991	89.66	157.2	136.3	165.4	$100,000	$63,630	$60,457
1992	91.85	161.0	140.4	170.4	$100,000	$62,118	$58,674
1993	94.05	164.9	144.6	175.5	$100,000	$60,660	$56,990
1994	96.01	168.3	148.3	180.0	$100,000	$59,425	$55,542
1995	98.10	172.0	152.5	185.1	$100,000	$58,156	$54,022
1996	100.00	175.3	157.0	190.5	$100,000	$57,053	$52,487
1997	101.95	178.7	160.6	195.0	$100,000	$55,963	$51,287
1998	103.23	180.9	163.1	198.0	$100,000	$55,270	$50,508
1999	104.77	183.6	166.7	202.3	$100,000	$54,454	$49,432
2000	106.99	187.5	172.3	209.1	$100,000	$53,328	$47,821
2001e	109.87	192.6	176.93	214.8	**$100,000**	**$51,926**	**$46,564**

e Estimate

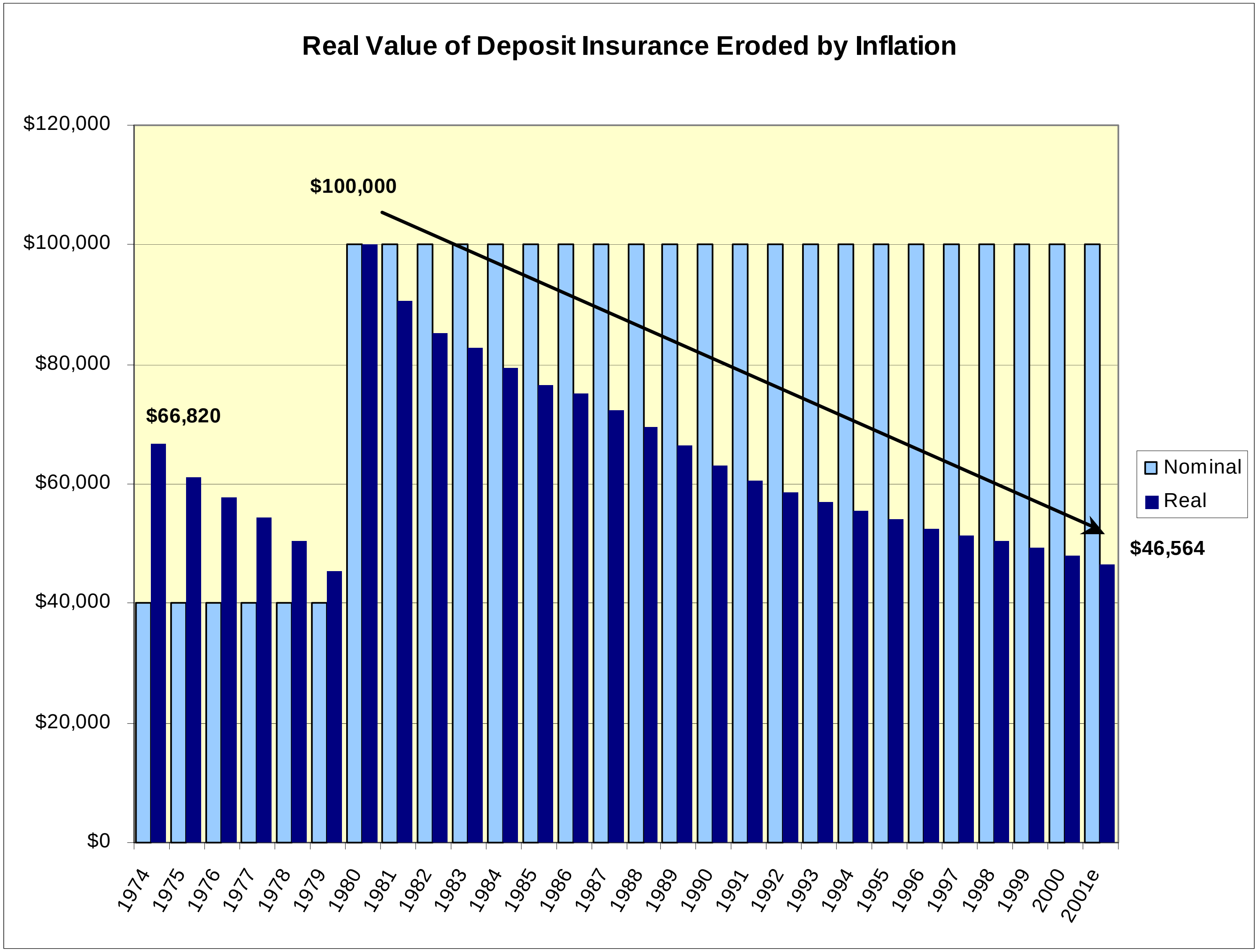
Source: Department of Commerce, Bureau of Economic Analysis. GDP Chain-Type Price Index, Bureau of Labor Statistics, Consumer Price Index CPI-U, and ICBA calculations.

CHART 1



Value of Deposit Insurance Coverage if Adjusted for Inflation Since 1980
$250,000
$200,000
$150,000
$100,000
$50,000
$0
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001e
GDP Chain
CPI-U
ICBA

CHART 2



Real Value of Deposit Insurance Eroded by Inflation
$120,000
$100,000
$80,000
$60,000
$40,000
$20,000
$0
$100,000
$66,820
$46,564
Nominal
Real
1974
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001e